BEFORE 'THE STATE BOARD OF EQUALIZATION

"OF'THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JOHN NORTON FARMS)

Appearances:

For Appellant: Hart H. Spiegel and
W. Scott Thomas
Attorneys at Law

For Respondent: Peter S. Pierson
Counsel

OP I N I ON

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of John Norton Farms against a proposed assessment of additional franchise tax in the amount of $248,747 for the income year 1975.

The questions presented in this appeal are: (1) whether a certain document submitted with appellant's return on September 15, 1977, qualified as a timely and sufficient application for extension of the California period to reinvest proceeds from the sale of real property in 1975 under the threat of condemnation; and (2) if not, whether another document filed after the expiration of such reinvestment period nonetheless qualified as an application for extension.

John Norton Farms is an Arizona corporation whose principal business activity is farming. On March 25, 1975, appellant, under threat of condemnation, sold two parcels of California real property used in its farming operations. Pursuant to section 1033 of the Internal Revenue Code and section 24944 of the Revenue and Taxation Code, appellant elected to defer recognition of its gain by reinvesting the sale proceeds in qualifred property. Appellant also elected the installment method to report any unreinvested gain.

At the time of the sale in 1975, the permissible reinvestment period under both federal and California law ended two years after the close of the first income year in which any part of the gain upon the conversion was realized. In 1976, however, the two-year period was changed to three'years at the federal level. This change applied'to sales made after December 31, 1974. California, however, did not make a corresponding statutory change until late 1977 and then only made the change applicable to sales made after December 31, 1975. Consequently, appellant's reinvestment period for California franchise tax purposes (exclusive of extensions) only ran until December 31, 1977.

Appellant embarked upon a program of reinvestment immediately after the 19'75 sale, but encountered difficulty in locating and acquiring suitable qualifying reinvestment property. As of the end of 1976, appellant had succeeded in reinvesting only about one-fourth of the condemnation proceeds.

In January of 1978 respondent initiated an audit of appellant's 1975 tax return. Since the reinvestment period had expired, respondent's auditor advised appellant that the unreinvested proceeds appeared to be includable in taxable income. Appellant responded by advising the auditor that a timely application for an administrative extension had been filed. Respondent's auditor examined a copy of the purported application and expressed an

initial opinion that it was timely, but insufficient. However, he decided to take the matter under advisement.

Appellant's purported application for extension came about in the following manner. Appellant had attached a copy of its 1976 federal return to its 1976 California return filed. September 15, 1977, and throughout the California return had referred to and incorporated various schedules in the federal return. Appellant's federal return included a Schedule F-22 which contained, among other things, the following declaration:

> Under threat of condemnation taxpayer sold property during 1975. Pursuant to Sec. 1033 (IRC) . . . , the gain was not recognized since taxpayer intends to reinvest proceeds in similar property within the statutory period. Date of sale 3/26/75.

[Resp. Br. Ex. A.]

The balance of that schedule contained details as to the total amount to be reinvested, the amounts reinvested subsequent to electing deferral, and the amount of gain not yet reinvested as of December 31, 1976.

In June of 1978, a notice of proposed assessment was issued based on a rejection of the claimed application for extension. Appellant then filed a protest on August 18, 1978. Along with the protest, appellant filed a secondary document in which it requested extension of the reinvestment period and included reasons in support of the request. On November 9, 1979, respondent denied appellant's protest of the determination that the Schedule F-22 was not an application for extension. Respondent also determined that the document submitted on August 18, 1978, was not filed timely and therefore required no action. Pursuant to these determinations, respandent affirmed its proposed assessment and this appeal followed.

Subsequent to the filing of the appeal, appellant informed respondent that, as a result of an Internal Revenue Service audit, gain realized on one of the parcels in question was required to be recognized but could be reported on the installment basis. Consequently, appellant and respondent now agree that such parcel should be accorded similar treatment at the state level. Accordingly, the discussion that follows is limited to the parcel unaffected by the federal determination.

Section 24944 of the Revenue and Taxation Code is substantially similar to section 1033 of the Internal Revenue Code and, therefore, interpretations of the federal statute are highly persuasive in construing the California statute (Rihn v. Franchise Tax Board, 131 Cal.App.2d 356, 360 [280 P.2d 893] (1955).) Section 24944 states, in pertinent part, that the reinvestment period ends

> (1) Two years after the close of the first income year in which any part of the gain upon the conversion is realized; or
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> (2) Subject to such terms and conditions as may be specified by the Franchise Tax Board, at the close of such later date as the Franchise Tax Board may designate on application by the taxpayer. Such application shall be made at such time and in such manner as the Franchise Tax Board may by regulations prescribe.

The Franchise Tax Board is empowered by subdivision (2) to extend the period, but whether an extension should or should not be granted in a particular instance is discretionary with the agency. (See Boyce v. United States, 405 F.2d 526, 532 (Ct.Cl. 1968).) Under these circumstances, this board is limited to a determination of whether the Franchise Tax Board abused its discretion in denying the extension. (Boyce v. United States, supra; Fort Hamilton Manor, Inc., 51 T.C. 707, 721 (1969), affd., 445 F.2d 879 (2d Cir. 1971).) Furthermore, the taxpayer has the heavy burden of proving that respondent's action was plainly arbitrary. (Kolstad v. United States, 276 F.Supp. 757, 761 (D. Mont. 1967).)

The first question before us is whether the Franchise Tax Board abused its discretion in determining that the copy of appellant's federal Schedule F-22 was not a sufficient request for extension.

The regulation in effect at the time under review required the application for extension to contain all the details in connection with the involuntary conversion and required the taxpayer to show reasonable cause for not being able to replace the converted property within the required period of time. (Former Cal. Admin. Code, tit. 18, reg. 24943-24947, subd. (b)(3)(C) (repealer filed July 5, 1983; Register 83, No. 28).)

The subject Schedule F-22 apprised respondent of certain facts concerning appellant's converted property and reinvestment intentions. However, no outright or inferential reference to an extension of the replacement period is evident anywhere in that document. There is also no mention of a desired extension.period or a justification for an extension. This is in marked contrast to the inclusion of such particulars on the August 18, 1978, document. Furthermore, the fact that the Schedule F-22 was included at all in appellant's California return appears due to nothing more than coincidence since that schedule was filed as part of an entire copy of appellant's federal return and no attempt was made to distinguish it or otherwise. bring it to respondent's attention at the time of filing; From these factors, it is clear to us that respondent did not abuse its discretion in determining that the Schedule F-22 did not constitute a sufficient application for extension.

This bring's us to the second document filed by appellant on August 18, 1978. As respondent conceded its sufficiency as'a request for an extension at the hearing on this matter, the only question is whether it was a timely post-reinvestment period request for extension.

As noted previously, granting an extension is discretionary with the Franchise Tax Board, and our review of respondent's determination is limited to the question of whetner or not respondent abused its discretion in making its decision. Appellant's burden in such a case' is to show that respondent's determination was arbitrary. Accordingly, the question before us now is whether appellant has shown that respondent abused its discretion in finding the second document in issue to have been submitted in an untimely fashion.

The applicable regulations provided that an application for extension of the replacement period was required to be filed prior to the expiration of such period, unless the taxpayer could show to the satisfaction of the Franchise Tax Board (1) reasonable cause for not' having filed the application within the required period of time, and (2) that the application was filed within a reasonable time after the expiration of such period. The regulation further provided that if a federal extension had been granted under comparable provisions of the Internal Revenue Code, and otner specified requirements had been satisfied, such action would be deemed reasonable cause for not having filed the application within the required period of time. (Former Cal. Admin. Code, tit. 18, reg. 24943-24947, subd.(b)(3)(C), supra.)

Appellant insists that when the federal time for reinvestment was changed by statute, this amounted to a federal granting of an extension such as, was deemed reasonable cause for late filing under respondent's regulations. While there is some surface appeal to this argument; we believe that respondent's regulation, in referring to the granting of a federal extension; contemplated the situation where an individual taxpayer applied for and was actually granted an extension'of time by the Internal Revenue Service beyond that fixed by statute. Appellant's situation, which involved a new statutory period set by Congress automatically available to a whole class of taxpayers, without requiring an individual request, does not seem to fall under that category. However, even assuming, arguendo, that appellant came within the federal extension provision, that would not be enough to show that respondent acted arbitrarily in treating appellant's application as untimely.

A late application for extension was acceptable only if respondent was satisfied that there was reasonable cause for the late'filing and that the application was filed within a reasonable time after the reinvestment period's end. We cannot now substitute our judgment for that of the Franchise Tax Board and decide independently whether or not appellant's post-reinvestment period application was filed within a reasonable time. Rather, the standard of review is simply to decide whether respondent abused its discretion in making the subject determination. Appellant did not file a second document requesting an extension until eight and one-half months after the expiration of the reinvestment period, yet it had been on notice for approximately seven of those months that the sufficiency of its previous submission was being questioned. Under the circumstances, we cannot conclude that respondent acted arbitrarily and capriciously in finding that the second document was not filed within a reasonable time after the expiration of the normal reinvestment period.

On the basis of the'foregoi'ng, we must sustain respondent's action, subject to the previously mentioned concessions.

Appeal of John Norton Farms

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of John Norton Farms against a proposed assessment of additional franchise tax in the amount of $248,747 for the income year 1975, be and the same is hereby modified to reflect the conceded treatment as to one of the parcels. In all other respects, the action of the Franchise Tax Board is hereby sustained.

Done at Sacramento, California, this 31st day of January, 1984, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Dronenburg, Mr. Collis, Mr. Bennett and Mr. Harvey present.

Richard Nevins, Chairman

Ernest J. Dronenburg, Jr., Member

Conway H. Collis, Member

William M. Bennett, Member

Walter Harvey*, Member

*For Kenneth Cory, per Government Code section 7.9